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ORDER NO. 1656

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners: Ruth Y. Goldway, Chairman;
Robert G. Taub, Vice Chairman;
Mark Acton;
Tony Hammond; and
Nanci E. Langley

Periodic Reporting
(Proposals Eight and Nine)

Docket No. RM2012-8

ORDER ON ANALYTICAL PRINCIPLES USED IN PERIODIC REPORTING (PROPOSAL NINE)

(Issued February 14, 2013)

I. INTRODUCTION

In Order No. 203, the Commission adopted periodic reporting rules pursuant to 39 U.S.C. § 3652.[1] Those rules require the Postal Service to obtain advanced approval, in a notice and comment proceeding under 5 U.S.C. § 553, whenever it seeks to change the analytical principles that it applies in preparing its periodic reports to the Commission required by section 3652.

[1] Docket No. RM2008-4, Notice of Final Rule Prescribing Form and Content of Periodic Reports, April 16, 2009 (Order No. 203).

On September 28, 2012, the Postal Service filed a petition pursuant to 39 C.F.R. § 3050.11 requesting that the Commission initiate an informal rulemaking proceeding to consider two proposals to change the analytical methods approved for use in periodic reporting.[2] On October 2, 2012, the Commission issued Order No. 1488 initiating this rulemaking proceeding; providing for the submission of comments and reply comments; and appointing a Public Representative.[3] Also on October 2, 2012, the Postal Service filed revisions to its library references.[4] On October 23, 2012, the Postal Service filed an errata to the library reference supporting Proposal Nine.[5] On December 6, 2012, the Commission approved Proposal Eight.[6]

Proposal Nine would make eight modifications to the Periodicals Flats Model and apply four of those modifications to First-Class Mail and Standard Mail Flats Models. The Commission approves Proposal Nine. Each modification in the proposal is discussed below.

II. MODIFICATIONS 1 AND 2

A. Postal Service Proposal

Modifications 1 and 2 are minor corrections to the Flats Models. Modification 1 removes the ability to isolate (via toggle switches) the effect of individual changes proposed in Docket No. RM2012-2. Petition at 5. Those changes were approved by

[2] Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposals Eight and Nine), September 28, 2012 (Petition).

[3] Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposals Eight and Nine), October 2, 2012 (Order No. 1488).

[4] Notice of Filing of USPS-LR-RM2012-8/NP1, Corrected Version of USPS-LR-RM2012-8/1, and Application for Nonpublic Treatment, October 2, 2012.

[5] Notice of Errata to Proposal Nine Attachment, October 23, 2012.

[6] Order No. 1567, Order on Analytical Principles Used in Periodic Reporting (Proposal Eight), December 6, 2012.

the Commission.[7] The Postal Service considers the switches to be superfluous. *Id.* This modification affects the models for all three classes.

Modification 2 corrects what the Postal Service describes as "cell referencing errors" in the Periodicals model. Specifically, the Postal Service proposes to correct cell references that incorporate bundle-related Flat Sequencing System (FSS)[8] costs. *Id.*

B. Participant Comments

The Public Representative comments on Modifications 1 and 2. The Public Representative supports approval of both.[9]

C. Commission Analysis

Modification 1 renames a tab in the spreadsheet and does not change any calculations within the models. The Commission accepts this modification, as it improves the organization of the Flats Models. With Modification 2, the Postal Service proposes to correct cell references that incorporate bundle-related FSS costs. Modification 2 is accepted, as it harmonizes the cell reference with the source explanation.

III. MODIFICATION 3

A. Postal Service Proposal

The third modification enhances the modeled flow of the Automated Flats Sorting Machine (AFSM 100) rejects in the Flats Models for First-Class, Standard, and Periodicals, making reject rates more consistent with those reported in Management

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[7] Order No. 1383, Order Concerning Analytical Principles for Periodic Reporting (Proposals Sixteen Through Twenty), June 26, 2012.

[8] The FSS is used to sort Flats into Delivery Point Sequence (DPS). Flats sorted to the 5-Digit or carrier route level can be sorted to walk sequence by DPS.

[9] Initial Comments of the Public Representative, October 29, 2012, at 2-3 (PR Comments).

Operating Data System (MODS) data. Petition at 6-8. There are several causes of rejected pieces on the AFSM 100 which can be classified as either in-scheme or out-of-scheme.[10] In-scheme rejects include remote encoding failure, failure due to the quality of the mailpiece, or mechanical problems. Out-of-scheme rejects are pieces that should not have been put on the machine for that sort scheme and are therefore rejected.

The current versions of the Flats Models only count as rejects mailpieces that are unable to be processed after a failed attempt by the Remote Encoding Center (REC) to read or apply a barcode. The Postal Service asserts that the current model understates the number of pieces needing additional handlings as measured by the ratio of MODS total pieces handled (TPH) to total pieces fed (TPF). *Id.* at 6. Thus, this modification, which incorporates rejects at operations other than REC, is intended to enhance the modeled flow of AFSM 100 rejects, improving the consistency with measured MODS statistics. *Id.*

In the case of FSS processing, the Postal Service proposes to do more than simply increase the reject rate. FSS rejects would flow to various operations depending on the cause of the reject. For example, if a piece fed to an FSS does not destinate in a zone being sorted at that time, the piece will be rejected. This out-of-scheme reject is modeled as being re-fed to the appropriate sort scheme on an FSS or flowing to an Incoming Primary (IP) operation on an AFSM 100. *Id.* at 7. If a piece is rejected by an FSS due to mechanical problems (an in-scheme reject), it is modeled as flowing to an Incoming Secondary (IS) operation on the AFSM 100. *Id.*

The Postal Service uses MODS End of Run reports to determine the proportion of FSS rejects that are out-of-scheme versus all other FSS rejects.[11] *Id.* It then uses this proportion to determine the volume of FSS reject mail flowing to the AFSM 100 IP and IS operations. *Id.*

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[10] The AFSM 100 is used to sort flat mail. The AFSM is capable of working an Incoming Secondary (IS) scheme that sorts mail from 5-Digit ZIP Codes to individual carrier routes.

[11] *See* Excel file "538 TPF TPHv Redact.xls" in library reference USPS-LR-RM2012-8/1.

The Postal Service notes that the model has not been modified to distinguish between out-of-scheme and in-scheme rejects from the AFSM 100 in the Outgoing Primary (OP), Outgoing Secondary (OS), Managed Mail Program (MMP), Sectional Center Facility (SCF), IP, and IS schemes. *Id.* at 8. It asserts that modification of the model to account for differences in out-of-scheme and in-scheme reject flows "would add considerable complexity to the model while improving the accuracy of the model very little."[12]

B. Participant Comments

Pitney Bowes and the Public Representative discuss Modification 3. Pitney Bowes supports the adoption of Modification 3.[13] It states that this modification improves the accuracy of the cost model. It references Time Inc.'s comments in Docket No. RM2012-2, that the Flats Models overstate FSS accept rates. *Id*. at 2. Pitney Bowes asserts that Modification 3 would correct this overstatement by using MODS accept rates, which account for more sources of rejects. *Id.* at 3.

The Public Representative raises two issues regarding Modification 3. First, the Public Representative contends that the Postal Service's method of accounting for rejected FSS scheme and non-scheme mail is inconsistent, at least in part, with the explanation provided by the Postal Service. PR Comments at 3-4. He states that the Postal Service estimates the volume of FSS scheme and non-scheme mail routed to an AFSM 100 using the sorted/fed ratio from the FSS for each OP, OS, MMP, and SCF sort level. *Id.* Yet, the Postal Service also states that FSS reject mail will be routed to the AFSM 100 at either IP processing or IS processing. *Id.* However, only the new SCF reject rates would correctly determine the number of FSS rejects routed to an

[12] *Id*. The Postal Service states, "Relative to the FSS, AFSM 100 rejects are low, and out-of-scheme rejects are less likely in OP, OS, MMP, SCF, and IP operations because most facilities only have a single sort plan in these operations. . . . Total rejects in AFSM 100 processing are around a third of FSS reject rates implying a much lower impact of any out-of-plan rejects on modeled costs." *Id*.

[13] Comments of Pitney Bowes Inc., October 29, 2012 (Pitney Bowes Comments).

AFSM 100. *Id.* The Public Representative appears to mean that FSS rejects, which are routed to the AFSM 100, partly depend on the REC rejection rate, *i.e.*, the barcode accept/reject rate, which is the same for OP, OS, MMP, SCF, and FSS. The Public Representative appears to be saying that if FSS rejects are supposed to be routed to an incoming primary or secondary sort on an AFSM 100, FSS rejects should not be based on barcode reject rates from OP, OS, and MMP levels.

Additionally, the Public Representative suggests that some of the FSS reject rates may be based upon sack or pallet breakage, which affects bundle downflow and ultimately both allied and direct piece costs. *Id.* at 4. He asserts that by including all non-scheme FSS breakage to pieces, any FSS-related bundle breakage will affect only direct, not allied, piece costs. *Id.*

In reply comments, the Postal Service explains that the SCF scheme has been used as a proxy for incoming reject rates for nearly a decade.[14] It contends that separate IS and IP reject rates were not introduced because the measured reject rates for these schemes did not differ from the SCF reject rates, and because the introduction of additional parameters would introduce unnecessary complexity to the model. Reply Comments at 2.

The Postal Service also addresses the Public Representative's concern that bundle breakage may be affecting the FSS reject rates. It contends that due to the way accept and reject rates are calculated, bundle breakage has no such effect. *Id.* at 3. The Postal Service explains that the accept and reject rates come from machine counts of pieces that were fed into the machine (TPF) and the pieces that were successfully sorted (TPH). *Id.* For the FSS, additional counts are obtained for pieces fed, but not successfully sorted, because the pieces destinate in a zone not currently processed on the machine. *Id.* Because these statistics are calculated based on pieces actually worked, bundle breakage has no effect. *Id.* It notes that the cost of bundle breakage is dealt with separately within the bundle cost portion of the model. *Id*.

[14] Reply Comments of the United States Postal Service, November 8, 2012, at 2 (Reply Comments).

C. Commission Analysis

The Postal Service proposes to account for more sources of rejects in the Flats Models and to adjust automation reject rates to make them consistent with MODS data. The data suggest that the existing model overstates the AFSM 100 and FSS acceptance rates.[15] The Commission finds that this modification better reflects current operations, thus improving the accuracy of the current cost models' estimates. Accordingly, the Commission accepts this modification.

The impact of this modification on unit costs is insignificant. However, as the flats processing operations evolve to optimize use of the FSS, the impact on worksharing cost avoidances may need to be reviewed. Currently, there are only 100 FSS machines in operation, and less than 5 percent of First-Class flats volume[16] and 17 percent of Standard and Periodicals flats volume are sorted on an FSS.[17]

Generally speaking, flats must be sorted to the 5-Digit level, either by the mailer or by the Postal Service, before being sorted on the FSS.[18] It should make little difference whether a mailer or the Postal Service prepares the 5-Digit mail. Consequently, the unit cost of the FSS operation should not differ markedly by rate category. However, in FY 2011, the flats models estimated noticeable differences in FSS costs between presort tiers.

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[15] The current accept rate for the FSS is 98.16 percent. Under Modification 3, it would become 89.39 percent. *See* Library Reference USPS-LR-RM2012-8/1, Excel file "FCM.Prsrt.Flats.1023.xls," sheet "ACCEPT RATES," cells G24 and K24.

[16] Library Reference USPS-LR-RM2012-8/1, Excel file "FCM.Prsrt.Flats.1023.xls," sheet "COVERAGE FACTORS", cell L77.

[17] Library Reference USPS-LR-RM2012-8/1, Excel file "PER.OC.Flats.0915.xls", sheet "FSS Parameters", cell L6; *id.,* Excel file "Std.Flats.MP.0915.xls", sheet "COVERAGE FACTORS", cell L77. 9.7 percent of non-HD and Saturation flat-shaped volume was processed on the FSS in FY 2011. 16.8 percent of non-HD and Saturation flat-shaped volume was processed on the FSS in FY 2012.

[18] Some mailers prepare flats for specific sort schemes at specific facilities, although there is no price incentive to do so. *See* Responses of the United States Postal Service to Questions 1-15, 17, 19-21, 23-26, 28-30, and 32-36 of Chairman's Information Request No. 5, February 6, 2013, Questions 19-20.

The following information concerning FY 2011 Periodicals FSS costs is illustrative.

MADC 0.946[19]
ADC 1.024[20]
3D 0.957[21]
5D 1.131[22]

On this record, whether the differences are due to mail characteristics related to worksharing or mail characteristics that are unrelated to worksharing (such as location of FSS machines) is unclear. The Commission has devoted significant resources to analyzing this question. As the usage of FSS evolves, the Commission will continue to monitor the worksharing impact of the FSS until sufficient information is available.

The Public Representative claims that the Postal Service proposes to use reject rates in OP, OS, and MMP operations on the AFSM 100 to determine the number of pieces rejected in FSS DPS operations. However, it does not appear that the Flats Models rely on AFSM 100 OP, OS, or MMP reject rates in the calculation of FSS rejects.[23] The Flats Models only use AFSM 100 OP, OS, and MMP reject rates to determine the number of rejects from the AFSM 100 (not the FSS) sometimes returned to the AFSM 100 for further processing.[24] The Commission therefore concludes that the proposed reject rates are correctly used in the Flats Models. Nonetheless, the Commission notes that the unexplained inclusion of separate proportions for scheme

[19] Library Reference USPS-LR-RM2012-8/1, Excel file "PER.OC.Flats.0915.xls", sheet "MADC New", cell K240.

[20] Library Reference USPS-LR-RM2012-8/1, Excel file "PER.OC.Flats.0915.xls", sheet "ADC New", cell K240.

[21] Library Reference USPS-LR-RM2012-8/1, Excel file "PER.OC.Flats.0915.xls", sheet "3D New", cell K240.

[22] Library Reference USPS-LR-RM2012-8/1, Excel file "PER.OC.Flats.0915.xls", sheet "5D New", cell K240.

[23] *See, e.g.,* Library Reference USPS-LR-RM2012-8/1, Excel file "PER.OC.Flats.0915.xls", tab 'ADC New', cell D94, which only uses FSS accept rates for FSS operations.

[24] *See, e.g.,* Library Reference USPS-LR-RM2012-8/1, Excel file "PER.OC.Flats.0915.xls", tab 'ADC New', cell D52, which uses MMP accept rates for the AFSM MMP operation.

and non-scheme rejects for the AFSM 100 OP, OS, MMP, and SCF operations in the "accept rates" sheets of the Flats Models is somewhat misleading. However, since scheme and non-scheme rejects from the AFSM 100 are routed to the same manual operations, these proportions have no impact on the modeled cost estimates.

IV. MODIFICATION 4

A. Postal Service Proposal

The fourth modification accounts for changes in allied operations resulting from the introduction of the AFSM 100 and FSS.[25] The modifications only apply to the Periodicals model. The Periodicals Outside County Flats Model contains a representation of both the direct piece-sorting operations and the allied operations needed to move volumes between piece-sorting operations. The Postal Service proposes to incorporate additional allied operations into the Periodicals model and to update the volume of mail flowing between operations to conform more closely to current operational reality. Petition at 9-10. The existing methodology for Periodicals allied flows was designed before deployment of the current generation of flats sorting machines, the AFSM 100 and FSS. The newer technologies have added additional allied activities between processing operations. The newer technologies have also changed the percentage of volumes that flow between processing operations. For this reason, with this modification, the Postal Service has added allied activities as applicable and has provided the volume of mail expected to flow into and out of each processing operation based on the volumes expected to move through an operation. Thus, the Postal Service concludes that this modification aligns the Periodical cost model with current operations. *Id.;* Reply Comments at 3.

[25] Allied operations are required for direct piece processing, but do not involve the sortation of mail. For example, moving a wheeled container of flats to a sorting machine is an allied activity.

B. Participant Comments

Two commenters discuss Modification 4: Magazine Publishers of America (MPA) and the Public Representative. The Postal Service also discusses Modification 4 in its reply comments.

The Public Representative notes that the new flow models generally result in more mechanized mail incurring costs from allied operations before being processed in the next direct piece-sorting operation.[26] The Public Representative also states that the "Postal Service has not provided any explanation, or justification, for the altered operational flows." PR Comments at 5. In its reply comments, the Postal Service, referring to its original proposal, claims the updated flows are needed to reflect the increase in "intra-facility allied activity due to increased mechanized IS processing." Reply Comments at 3.

MPA does not comment on the technical or conceptual aspects of Modification 4, but does discuss the implications if implemented.[27] Modification 4 would increase allied piece costs and decrease all other modeled costs.[28] MPA claims that this increase "adds to the urgency of having the Commission resolve how allied piece-related costs should be treated for rate design purposes." MPA Comments at 2. Further, MPA asserts that including allied costs in Periodicals passthroughs is "required for consistency with the methods used to estimate cost avoidances in other classes of mail" and to "maintain internal consistency *within* the Periodicals Mail Cost Model." *Id.* at 2-3 (emphasis in original). MPA also "urges the Commission to again remind the Postal Service to provide appropriate and full incentives for efficient mail preparation." *Id.* at 3.

[26] Mechanized mail is mail sorted by mail processing equipment.

[27] Comments of MPA – The Association of Magazine Media, October 31, 2012, at 1-3 (MPA Comments).

[28] The Cost and Revenue Analysis (CRA) adjustment factor declines from 1.16 to 1.12, which is a 3.48 percent decrease. All non-allied cost drivers are impacted by this decrease in the CRA adjustment factor, such as Barcoded Machinable 5-Digit flats. The CRA adjusted direct piece cost for Barcoded Machinable 5-Digit flats declines from 10.7 cents to 10.3 cents.

The Postal Service responds that MPA's comments "discuss workshare cost avoidances and pricing issues, but do not opine on either of the two proposals at issue in this docket; they would therefore be better suited to another docket." Reply Comments at 1 n.1.

C. Commission Analysis

The Commission approves Modification 4 because it updates allied operations for consistency with current operations, yielding more accurate cost estimates. As improved by Modification 4, the Periodicals Flats Model include 7 allied operations, 89 "flowcodes," and approximately 600 mail flows. Modification 4 adds a worksheet called FLOWCODES as well as "Allied Flow" worksheets for the Mixed Area Distribution Center (MADC), Area Distribution Centers (ADC), 3D, and 5D models. Presumably, the purpose of adding these worksheets is to make it easier to modify the treatment of allied operations in the future. For all its increased complexity, the addition of these five worksheets results in only minor substantive changes affecting only the MADC model.[29]

The updating of volume flows between operations included in Modification 4 increases modeled allied piece-handling costs by roughly $40 million. The increase in allied operational costs has two impacts. First, it causes the CRA adjustment factor to decrease.[30] Second, that decrease in turn leads to a decrease in the total adjusted modeled costs for direct piece operations,

[29] Modification 4 adds two new allied operations at origin area distribution centers (OADCs). *Compare* Library Reference USPS-LR-RM2012-8/1, Excel file "PER.OC.Flats.0915.xls", sheet "MADC New", cells B172-176 *with id.,* sheet "MADC", cells B127-129. All other allied operations in column B of those sheets are the same. The same OADC operations are included in the other models, but the volume in the other models is zero. The zero volume results in zero cost in the other models. *Compare id.,* sheet "MADC New", cells C172-176 *with id.,* sheets "ADC New", "3D New", and "5D New", cells C172-176.

[30] Allied mail processing costs are included in the total modeled cost in cell E95 of tab 'CRA Flats' in the Periodicals model. Cell F95 contains the CRA mail processing cost for Periodicals. Cell E99 in the tab 'CRA Flats' contains the calculation of the CRA adjustment. The formula for cell E99 is a fraction: cell F95 divided by cell E95, the CRA cost divided by the total modeled cost. As allied costs increase, the value in cell E95 (the denominator of cell E99) increases. Thus, the adjustment needed to match the modeled cost to the CRA cost (cell E99) declines.

as well as for bundle- and container-related costs.[31] The CRA adjustment factor for Outside County Periodicals flats decreases from 1.16 to 1.12.[32] This is associated with a roughly 4 percent decrease in adjusted modeled costs for non-allied cost drivers. The lower CRA adjustment highlights how Modification 4 improves the Periodicals model. By explicitly including more operations in the Periodicals model, Modification 4 appropriately captures more of the cost of processing Periodicals. The Periodicals cost model thus better reflects current operations.

Modification 4 raises two important issues beyond the scope of this proceeding. Neither is fatal to adoption of Modification 4. The first issue is the growing disparity between the modeling of allied operations in the Periodicals model compared with the First-Class and Standard models, which do not model the majority of allied piece operations.

Periodicals is the only class that has separate rates for containers. Consequently, the Periodicals processing model includes the flows of containers between processing operations before the containers are opened and the mail inside is sorted. These container-movement costs are allied costs. This is one of the reasons that allied costs are treated differently in the Periodicals model than in Flats Models for other classes. Beyond the container costs, the Periodicals model includes significantly more allied operations than have been modeled for other classes.[33] Similar allied

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[31] In the Periodicals model, the summary statistics for direct and allied piece mail processing costs, bundle costs, and container costs are calculated in the 'Summary' tab. In each of these tables, the modeled cost is multiplied by the CRA adjustment factor, found in cell E99 of tab 'CRA Flats.' An example of this would be the direct piece cost of Barcoded Machinable 5-Digit flats, for which the CRA adjusted direct piece cost can be found in cell F30 of tab 'summary.' The modeled cost of the Barcoded Machinable 5-Digit flats is 9.2 cents (cell F616 of tab 'direct piece calc'), and this modeled cost is multiplied by the CRA adjustment factor of 1.12 (cell E99 of tab 'CRA Flats') for the CRA adjusted cost of 10.3 cents. If the proposed allied flows are not included, the CRA adjustment factor is 1.16, and the CRA adjusted direct cost of Barcoded Machinable 5-Digit flats is 10.7 cents.

[32] *Compare* cell E99 of tab 'CRA Flats' *with* the modification switch for allied flows in cell A9 of tab 'Modifications' turned "ON" and "OFF".

[33] *Compare* Library Reference USPS-LR-RM2012-8/1, Excel file "PER.OC.Flats.0915.xls", sheet "MADC New", cells A152:K252 (explicit allied operations) *with id.,* Excel file "FCM.Prsrt.Flats.1023.xls," sheet "MADC AUTO MODEL NEW" (no allied operations).

operations occur for flats in classes of mail besides Periodicals. The cost models for those classes can and should be updated to better reflect current operational reality. The updated allied flows increase the accuracy of the modeled Periodicals piece cost, and would increase the accuracy in other classes.

The second issue not directly related to this proceeding was raised by MPA. It advocates for the inclusion of allied costs for purposes of calculating worksharing cost avoidances. MPA Comments at 3. MPA has raised this issue in two prior proceedings.[34] In both cases the Commission found MPA's suggestion to be beyond the scope of the proceeding.[35] However, in both cases the Commission said that it would consider the proposal to change the methodology of calculating worksharing cost avoidances for flats in a docket that would permit more deliberation. Rather than petition for a methodology rulemaking on its proposal, MPA has again raised the issue in a proceeding not related to or appropriate for measuring cost avoidances. The proper venue for examining Periodicals worksharing benchmarks is a rulemaking with that focus.

V. MODIFICATION 5

A. Postal Service Proposal

Not all flats are processed on an FSS. The proportion of flats receiving FSS processing is called the FSS coverage factor. The current versions of the First-Class, Standard, and Periodicals Flats Models filed by the Postal Service and approved by the Commission assume that FSS coverage factors are the same for First-Class Mail,

[34] *See* Docket No. RM2009-1, Comments of Magazine Publishers of America, Inc., and Alliance of Nonprofit Mailers, December 1, 2008, at 4-5; Docket No. ACR2007, Comments of Alliance of Nonprofit Mailers and Magazine Publishers of America, Inc., January 30, 2008, at 13-16.

[35] *See* Docket No. RM2009-1, Order Concerning Costing Methods Used in Periodic Reporting (Proposal Twelve), January 12, 2009, at 20 (Order No. 170); Docket No. ACR2007, Annual Compliance Determination, March 27, 2008, at 80-82.

Standard Mail, and Periodicals.[36] The Postal Service states that this coverage factor actually varies by class. Petition at 10. Thus, the Postal Service proposes to use cost estimates to distribute MODS TPF to each class and generate class-specific coverage factors as the ratio of distributed MODS FSS TPF to eligible Revenue Pieces and Weight volume. *Id.* at 11.

B. Participant Comments

The Public Representative and Pitney Bowes filed comments regarding Modification 5. The Public Representative recognizes that different classes will have different percentages of mail processed on the FSS. PR Comments at 6. However, he is concerned that the Postal Service's proposed methodology calculates coverage factors based on costs rather than on volumes. *Id.* Expressing an expectation that a greater volume of First-Class Flats than Periodicals could be processed on an FSS in a given amount of time, the Public Representative concludes that using costs, as opposed to volumes, underestimates the FSS coverage factor for First-Class Mail while increasing it for Standard Mail and Periodicals. *Id.* He recommends that the Commission determine whether volume shares are obtainable from the Postal Service. *Id.* If volume shares are not currently available, the Public Representative recommends that the Postal Service establish a timeline for when volume share data will be available. *Id.* at 6-7.

In its reply comments, the Postal Service agrees with the Public Representative that using volume data to calculate coverage factors is preferable to using cost data. Reply Comments at 2. However, the Postal Service does not have FSS volume data by class, and contends that the cost to collect the data would be exorbitant. *Id.* It suggests that Intelligent Mail barcode (IMb) technology may assist in developing such information, but at present, IMb "utilization is not sufficient to provide the necessary

[36] *See* Docket No. RM2012-2, Library Reference PRC-RM2012-2-LR1 (revised), July 13, 2012. (All three Flats Models utilize the same FSS coverage factor of 8.92 percent.)

information." *Id.* at 4. In addition, the Postal Service states that all classes of mail are handled on the FSS at the same time. Therefore, there is no productivity difference between the pieces of different classes, and "operation cost is an accurate and appropriate measure of relative volume by class." *Id.*

Pitney Bowes believes that Modification 5 is an improvement over the current method and should be adopted. Pitney Bowes Comments at 1.

C. Commission Analysis

The Commission approves Modification 5. While not ideal, the Postal Service's use of cost data to calculate coverage factors represents an improvement over the current methodology, which assumes that coverage factors are identical for each class of mail.

The Public Representative and the Postal Service are in agreement that volumes would be the best data for calculating FSS coverage factors. Once IMb utilization is sufficient, the Postal Service should file a petition to update the Flats Models. Until volume data are available, the use of cost data is a reasonable proxy to calculate class—specific coverage factors.

The Postal Service states that all classes of mail are processed at the same time in order to put all flats into proper sequence for carriers. All flats processed on the FSS must meet the same machinability standards. Therefore, "there is no perceptible difference in the way pieces of different classes are worked." Reply Comments at 4. The Public Representative's concern about the possible overstatement of coverage for First-Class flats is not supported by any record evidence. Further, these concerns may be allayed when IMb information can be used to provide volume share by class.

VI. MODIFICATION 6

A. Postal Service Proposal

The sixth modification removes the costs of sorting mail to post office boxes from all three Flats Models and designates these costs as "non-modeled." Petition at 11. This revision pertains to the CRA adjustment factor which contains a proportional component and a fixed per-piece component. The proportional component relates to the degree of worksharing and is sometimes referred to as workshare related. The per-piece component reflects mail processing costs that do not vary with the degree of worksharing. This component is sometimes referred to as non-modeled or non-worksharing related cost.

B. Participant Comments

Time Inc. and the Public Representative comment on this proposed change. The Public Representative supports the proposal. PR Comments at 7. Time Inc. opposes adoption of Modification 6.[37]

Time Inc. disagrees with the Postal Service's assertion, Petition at 11, that the cost of post office box distribution is unlikely to be correlated with preparation characteristics. It believes that the Postal Service could use mail.dat information, from Periodicals and other flats' mailers, to develop precise information about the incidence of post office box distribution across presort levels. *Id.* at 2. Time Inc. conducted a limited experiment in which it examined the presort characteristics of the November 5 issue of *People* magazine. Based on the results, Time Inc. asserts that there appears to be a very high correlation between post office box distribution and preparation characteristics, contrary to the Postal Service's assumption. *Id.* at 3.

Time Inc. contends that it is improper to exclude post office box distribution costs from the Flats Models while including delivery costs for mail delivered to street

[37] Comments of Time Inc. on Proposal Nine, October 29, 2012, at 2-3 (Time Inc. Comments)

addresses. *Id.* at 2. Post office box distribution is performed for certain flats as an alternative to carrier delivery. Time Inc. states that ordinarily the Commission considers both modeled mail processing costs and delivery costs when calculating cost differentials between presort levels to determine whether workshare discounts exceed avoided costs. It argues that "[i]t would be inappropriate in such a comparison to exclude costs that are incurred by" some, but not all, flats. *Id.*

In reply comments, the Postal Service argues that piece distribution costs for mail destinating at a post office box are the same, regardless of the level of workshare activities performed. Reply Comments at 1. In contrast to worksharing activities, post office box distribution costs are incurred by all mail destinating at a post office box, regardless of mail preparation, *i.e.,* whether single-piece or presorted. *Id.* at 2. For this reason, the Postal Service concludes that it is appropriate to exclude these costs from modeled costs and to treat them in the same manner as forwarding and acceptance costs. *Id.*

C. Commission Analysis

The Commission approves Modification 6. Time Inc. may be correct that post office box distribution is correlated with preparation characteristics. However, the extent to which a piece is workshared (or not) would not appear to affect the cost of distributing it to a post office box. Time Inc. has not explained why it should take more (or less) time to sort a flat to a post office box depending on how the piece is prepared and entered. It is unclear on this record whether the differences found by Time Inc. are due to mail characteristics related to worksharing or mail characteristics that are unrelated to worksharing (such as income of boxholders). The Commission has devoted significant resources to analyzing this question. However, based on the record in this proceeding, the costs of sorting mailing to post office boxes are properly treated as non-modeled, *i.e.,* non-worksharing related.

VII. MODIFICATIONS 7 AND 8

A. Postal Service Proposal

Modifications 7 and 8 involve the cross-docking matrix used to estimate container costs in the Periodicals model. Modification 7 updates the method used to develop the cross-dock matrix. Modification 8 simplifies the matrix and concurrent cost estimation.

Modification 7. The seventh modification updates the estimates of the average number of cross-dock movements by type of container and entry facility for Periodicals. Each cross-docking activity is associated with a modeled cost.[38] The cross-docking matrix is used to determine the probability that a specific container will be worked in each of the modeled activities. These probabilities are used to calculate the modeled cost of processing each type of container. In Docket No. R2006-1, the cross-docking estimates were developed using data from a survey of facility sort schemes and container volumes. Petition at 12.

In Modification 7, the Postal Service proposes to use FY 2012 Q1 transportation route data instead of survey data to develop the cross-docking estimates. Where specific route information was not available, labeling lists and parent facility assumptions were used. Further, the Postal Service smoothed the handlings to avoid anomalous results in sparsely populated cells of the matrix.[39] The Postal Service states that the new estimates are generally similar to those provided in Docket No. R2006-1. *Id.* at 11-15.

Modification 8. The eighth modification uses the results of the seventh modification to simplify the development of costs by type of container and entry facility

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[38] For example, entering and cross-docking a pallet at the SCF costs $11.46. *See* Library Reference USPS-LR-RM2012-8-1, Excel file "Per.OC.Flats.0915.xls", tab 'SCF-3D PALLETS', cell D7.

[39] The Postal Service calculated the handling incidence for each container type, *e.g.*, ADC presorted OADC entered and SCF OADC entered. The handling counts were then aggregated for all containers, *e.g.*, all OADC handlings were counted together. The additional marginal handlings incurred by OADC containers compared to OBMC (ONDC) containers were used for each presort level to determine handling incidence. This prevented anomalous results, such as OBMC 5-Digit pallets, of which there were 13 in Q1 FY 2012.

for Periodicals. The current methodology for calculating the total handling cost for every type of container is a matrix of each possible combination of handling occurrence and handling cost. In Modification 8, the Postal Service proposes to use a simplified matrix of handling occurrence and handling cost to determine the total handling cost for containers. According to the Postal Service, simply knowing the number of facilities that a container passes through before it reaches the destination facility is sufficient to calculate the number of times the average container incurs each process. *Id.* at 15-18.

B. Participant Comments

Modification 7. The Public Representative supports the use of a "continually updated transportation database to estimate handlings." PR Comments at 8. The Public Representative expresses concern regarding the large shift from pallet handlings to sack handlings for containers entered at an origin bulk mail center (OBMC). The Public Representative also provides a list of questions regarding the calculation methods used by the Postal Service. In its reply comments, the Postal Service addresses many of the questions posed by the Public Representative. Specifically, the Postal Service clarifies that both the transportation database and the eVS and PostalOne! databases used in Modification 7 are "continuously" updated. Reply Comments at 4. The Postal Service also notes that origin network distribution centers containers are rare, accounting for less than 1 percent of all Periodicals containers. *Id.* at 5.

Modification 8. The Public Representative states that Modification 8 "yields the identical container cost by entry facility as the previous method, but is substantial reduction in workload." PR Comments at 10. The Public Representative supports this proposal.

C. Commission Analysis

The Commission approves both Modifications 7 and 8.

Modification 7. The Postal Service proposes to update container cross-docking estimates by using FY 2012 transportation route data instead of survey data developed in 2005. While census data are not available at this time, Modification 7 relies on more current information and can be updated. The Postal Service states that use of parent-facility and labeling-list assumptions is necessary. The Commission expects that as the Postal Service improves its surface transportation visibility databases, through its Surface Visibility program, it will incorporate that information into the Periodicals Flats Model.[40] In sum, Modification 7 is an improvement over the current model and is approved. As the Postal Service moves forward with network realignment, it should update cost models to reflect the new network. Modification 7 will facilitate performance of this task.

Modification 8. Modification 7 updates container cross-dock flows. These container handling occurrences are then used to calculate handling costs by assigning a cost to each handling activity. In Modification 8, the Postal Service proposes to use a simplified matrix of handling occurrences and handling costs to determine the total handling cost for containers. The current methodology for calculating the total handling cost for every type of container is a matrix of each possible combination of handling occurrence and handling cost. The simplified matrix identifies six types of container costs and determines the occurrence for each of type of handling for each type of container.

Modification 8 does not materially impact the results of the container calculations. However, it significantly reduces the complexity of the Periodicals Flats Model. Accordingly, Modification 8 is accepted.

[40] For information on the Surface Visibility program, *see* Audit Report-Evaluation of Major Transportation Technology Objectives, United States Postal Service Office of Inspector General, September 27, 2011, *www.uspsoig.gov/foia_files/nl-ar-11-008.pdf*.

It is ordered:

For purposes of periodic reporting, the Commission accepts the changes in analytical principles proposed by the Postal Service in Proposal Nine in Docket No. RM2012-8 as set forth in the body of this Order.

By the Commission.

Shoshana M. Grove
Secretary